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IN THE

Supreme Court of the United States

OCTOBER TERM, 1943

NO.

HARTFORD FIRE INSURANCE COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

The petitioner prays that a writ of certiorari issue to review the decision of the Circuit Court of Appeals for the Second Circuit entered in the above entitled cause on March 23, 1944 reversing the decision of the Tax Court.

JURISDICTION

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925 (28 U. S. C. A., Sec. 347).

OPINION BELOW

The opinion of the Tax Court (R. 17) is unreported. The opinion of the Circuit Court of Appeals (R. 49) is not yet reported.

STATUTE INVOLVED

The statute involved is the Revenue Act of 1928, c. 852, 45 Stat. 791, and provides, as far as material herein:

> SEC. 311. TRANSFERRED ASSETS.[1]
>
> (a) Method of collection.—The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, collected, and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in a tax imposed by this title (including the provisions in case of delinquency in payment after notice and demand, the provisions authorizing distraint and proceedings in court for collection, and the provisions prohibiting claims and suits for refunds):
>
> (1) Transferees.—The liability, at law or in equity, of a transferee of property of a taxpayer, in respect of the tax (including interest, additional amounts, and additions to the tax provided by law) imposed upon the taxpayer by this title.
>
> * * * * *
>
> Any such liability may be either as to the amount of tax shown on the return or as to any deficiency in tax.
>
> * * * * *
>
> (f) Definition of "transferee".—As used in this section, the term "transferee" includes heir, legatee, devisee, and distributee.

[1] Section 311 of the Revenue Act of 1932, c. 209, 47 Stat. 169, is identical.

QUESTION PRESENTED

Whether a stockholder of a New York corporation which on March 1, 1907 leased its entire properties to a New York lessee for a period of ninety-nine years at an annual rental payable directly to the lessor's stockholders in proportion to their stock holdings is liable as a transferee for the payment of the lessor's entire income taxes for the years 1931, 1932 and 1933 amounting to $840, $1375 and $1375 respectively because in each of the years 1931 to 1940 it owned 350 of 2,000 outstanding shares of the lessor and received $1750 of the annual rental of $10,000.[2]

STATEMENT

The facts were stipulated (R. 28-48) and may be summarized as follows:

On March 1, 1907 Brooklyn Telegraph & Messenger Company, a New York corporation, leased all its property to National District Telegraph Company,[3] a New York corporation, for ninety-nine years at an annual rental of $10,000, being a sum equivalent to 5% per annum on the lessor's capital stock of the par value of $200,000 (R. 28).

The lease agreement provided that the rentals should be paid by the lessee directly to the lessor's stockholders in proportion to their stockholdings and the stock certificates were endorsed with guaranties of payment by the American District Telegraph Company of New

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[2] If the answer to this question is in the affirmative, the stockholder is similarly liable for the lessor's income taxes for each of the years following 1933.

[3] The name of this company was later changed to American District Telegraph Company, Inc.

Jersey, a New Jersey corporation. The lessor was obligated not to engage in any manner in any telegraph or other business during the continuance of the agreement. The lessee was required to pay all taxes imposed on the leased property by any State or municipal authority, to keep the lessor's stock books as the lessor's agent but at the lessee's expense, and to bear all expense of maintaining the lessor's corporate existence. In case of default, the lessor was entitled to recover possession of the leased property, but the lessee remained liable nevertheless, upon all of its covenants including the payments to the lessor's stockholders (R. 31-39).

The lease has been continuously in effect at all times from its inception and in each of the years 1931-1940 the petitioner owned 350 of the lessor's 2,000 shares and received $1750 of the annual rental of $10,000. (R. 29)

The lessor's income tax returns for the taxable years 1931, 1932 and 1933 reported income of $201.40, $201.80 and $196.60 respectively, these amounts representing New York State and City taxes paid by the lessee on the lessor's behalf, and said returns showed deductions in the same amounts. (R. 30, 40-48)

The Commissioner assessed deficiencies against the lessor for said years, based on the inclusion in its income of the annual rentals aforesaid, of $840, $1375 and $1375 respectively. A warrant of distraint having been returned unsatisfied, the Commissioner determined that the petitioner was liable as a transferee of property of the lessor for the full amount of the deficiencies, viz. $3590, and interest. (R. 30-31)

The Tax Court's decision that the petitioner was not liable as a transferee was reversed by the Court Below.

REASONS FOR GRANTING THE WRIT

1. The Lower Court's imposition of transferee liability in disregard of State law was based upon a misconstruction of this Court's decision in *U. S. v. Joliet & Chicago R. Co.*, 315 U. S. 44 (1942).

2. If the imposition of transferee liability is a question of Federal law, the extent to which the Federal law should disregard the State law should be decided by this Court.

3. The petitioner is not a transferee of property of the lessor within the intent of the transferee provisions of the 1928 and 1932 Revenue Acts.

4. A review of the Lower Court's decision by this Court will prevent litigation on the same question in other Circuits and a probable conflict in the decisions of the various Circuit Courts of Appeals.

BRIEF AND ARGUMENT

1. The Lower Court's imposition of transferee liability in disregard of State law was based upon a misconstruction of this Court's decision in *U. S. v. Joliet & Chicago R. Co.*, 315 U. S. 44 (1942).

Prior to the decision of the Lower Court in the instant case it was apparently settled that the transferee provisions of the income tax laws[4] imposed no new obligation upon the transferee of property of the taxpayer but was intended to provide a summary method of enforcing such liability as might already exist under the State law.[5]

Under the New York law it has long been established that a lease such as that in the instant case divests the

[4] These provisions first appeared as Section 280 of the Revenue Act of 1926.

[5] *Phillips v. Commissioner*, 283 U. S. 589, 594 (1931); *Harwood v. Eaton*, 68 F. 2d 12, 13 (C. C. A. 2, 1933), cert. den. 292 U. S. 636 (1934).

lessor of all rights of ownership or control in the rentals and vests these rights in the lessor's stockholders.[6]

Accordingly, in *Harwood v. Eaton*, 68 F. 2d 12 (1933) certiorari denied 292 U. S. 636 (1934) and *Western Union Telegraph Co. v. Commissioner*, 68 F. 2d 16 (1933) certiorari denied 292 U. S. 636 (1934), the Lower Court held that a stockholder of the lessor under a New York lease of this type did not receive his share of the rentals as a transferee of property of the lessor and hence was not liable as a transferee for the payment of the lessor's income taxes.

In the instant case the Lower Court, with what was virtually a dissent by Judge Swan, overruled its decisions in the *Harwood* and *Western Union* cases and held that the petitioner was liable as a transferee on the assumption that the decision of this Court in *U. S. v. Joliet & Chicago R. Co.*, 315 U. S. 44 (1942) required it to hold that the lessor "constructively" received the rentals from the lessee and "in effect" distributed them to the stockholders.[7]

The Lower Court recognized that its decision was in conflict with the New York law and was therefore forced to take the position that the imposition of transferee liability was not governed by State law but was a question of Federal law and that this was implicit in the theory of the *Joliet* decision.

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[6] See cases cited in *Western Union Telegraph Co. v. Commissioner*, 68 F. 2d 16, 17 (1933), cert. den. 292 U. S. 636 (1934).

[7] The opinion written by Augustus N. Hand, J. states: "It seems to us that the mode of treatment of the relations between the lessor and its stockholder in *United States v. Joliet & Chicago R. Co.* * * * requires us to hold that the lessor not only exists as an entity independent of its stockholders but that it constructively receives rentals from the lessee and in effect distributes them as annual dividends to its shareholders." (R. 54).

In the *Joliet* case, however, this Court held only that the connection between the lessor and the payment of the rentals arising from the fact that the rentals were payable to the lessor's stockholders and were so payable as the result of the lessor's command at the time the lease was made was sufficiently close so that it might properly be said that the taxation of the rentals to the lessor was within the scope of the legislative intent.[8]

In its opinion this Court made no attempt to support its decision either by a suggestion that the lessor retained any ownership or control over the rentals or by a resort to the fiction that the rentals were constructively received by the lessor. Moreover, it expressly rejected this approach for it dismissed the respondent's contention that the lessor did not own and had no control over the rentals and therefore could not be in receipt of income "constructively or otherwise", not by denying its validity but by pointing out that these considerations did not dispose of the controversy.[9]

Hence the opinion of this Court in the *Joliet* case did not require the Lower Court to hold that the lessor constructively received the rentals and in effect distributed them to its stockholders, and the Lower Court's assumption that this was the case, that it must therefore disregard the State law and hold the petitioner liable as a transferee and that the imposition of such liability was therefore a question of Federal law was erroneous.

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[8] This holding in no way conflicts with the New York law as to the ownership and control of the rentals.

[9] The opinion written by Mr. Justice Douglas states: "Respondent therefore contends that a corporation which does not own or control property and has no right to or control over any income from the property cannot be in receipt of income constructively or otherwise."

"Such considerations do not dispose of this controversy." *U. S. v. Joliet & Chicago R. Co.*, 315 U. S. 44, 46 (1942).

2. If the imposition of transferee liability is a question of Federal law, the extent to which the Federal law should disregard the State law should be decided by this Court.

In *Harwood v. Eaton*, 68 F. 2d 12 (1933) certiorari denied 292 U. S. 636 (1934) the Lower Court held that the conclusion that the imposition of transferee liability was a question of State law was a necessary implication from the opinion of this Court in *Phillips v. Commissioner*, 283 U. S. 589 (1931) in view of this Court's statement (at p. 594) that the transferee provisions of the 1926 Act provided "the United States with a new remedy for enforcing the existing 'liability at law or in equity' " and despite this Court's statement (at p. 602) that there was "no occasion to decide whether the right of the United States to follow transferred assets is limited by any state laws".

In the instant case the Lower Court took the view that in the *Phillips* case this Court had "reserved the general question . . . 'whether the right of the United States to follow transferred assets is limited by . . . state laws' " (R. 55), that the decision of this Court in *U. S. v. Joliet & Chicago R. Co.*, 315 U. S. 44 (1942) required the imposition of transferee liability upon the petitioner despite the fact that this was in direct disregard of the New York law and that the imposition of such liability was therefore a question of Federal law.

As pointed out in the preceding section of this brief, the Lower Court's conclusions were based on a misconstruction and misapplication of the *Joliet* decision.

Hence, this Court has not decided either that the imposition of transferee liability is a question of Federal law or, if it is a question of Federal law, the extent to which the Federal law should disregard the State law.

It is submitted that these questions should be decided by this Court in view of the large number of existing leases of the type here involved and the importance of these questions to all holders of guaranteed stocks.

3. The petitioner is not a transferee of property of the lessor within the intent of the transferee provisions of the 1928 and 1932 Revenue Acts.

The instant lease having been made long before the enactment of the present income tax laws, the imposition of transferee liability cannot, of course, be based upon any transfer from the lessor to its stockholders at the time the lease was executed.

Moreover, the connection between the lessor and the payment of rentals relied upon by this Court in *U. S. v. Joliet & Chicago R. Co.*, 315 U. S. 44 (1942) to hold the rentals taxable to the lessor has no relevancy with respect to the question whether a stockholder should be held to be liable as a transferee of property of the lessor.

Hence, to impose such liability it is necessary to resort to the fictions that the rentals belong to and are received by the lessor and are distributed by it to its stockholders.

But a resort to these fictions to impose transferee liability would seem to be wholly unjustified. The imposition of such liability would give the transferee provisions in question a scope far beyond the plain import of their language.[10] It would disregard the New York law that the rentals are the property of the stockholders.[11] It would effect the complete bewilderment of

[10] These provisions obviously contemplate a situation wherein the taxpayer owning an interest in property which could be resorted to by the government for the payment of its tax transfers this interest to a transferee.

[11] It is assumed that it was to avoid this result that this Court refused to resort to these fictions in the *Joliet* case.

a stockholder who having acquired his stock on the assumption that it would give him a fixed return each year which he could retain as his own suddenly finds that he has subjected himself to a liability which may not only deprive him of everything he has received but, to the extent he has paid his own taxes thereon, to an actual out-of-pocket loss.[12] And finally, it would subject a stockholder to a most harsh and inequitable result for, as illustrated by the instant case, a stockholder owning a relatively small minority interest in the lessor's stock and receiving a correspondingly small share of the annual rentals, could be repeatedly held liable for the lessor's income taxes based on the full amount of the rentals and his rights of contribution against the remaining stockholders would be enforceable only by recurrent suits, many of them against small stockholders for small amounts, and at prohibitive expense. Moreover, as to many of these stockholders, e.g. those who could not be found or were insolvent, his rights of contribution would be unenforceable.

In *U. S. v. Warren R. Co.*, 127 F. 2d 134 (1942) and *U. S. v. Morris & Essex R. Co.*, 135 F. 2d 711 (1943), certiorari denied 88 L. E. 33 (1943), the Lower Court held that the Government might enjoin a lessee under a lease such as that in the instant case from paying any future rentals until such time as the Collector had an opportunity to levy upon them for the lessor's income taxes. Although these decisions are difficult to support,[13]

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[12] cf. Pound, *An Introduction to the Philosophy of Law*, at p. 189: "The law enforces the reasonable expectations arising out of conduct, relations and situations."

[13] In the *Warren* case the Lower Court based its decision upon the premise that the rentals belonged to the lessor and not to its stockholders. In the *Morris & Essex* case it relied upon the premise that the lessor and its stockholders were so much the same person or

the remedy they permit is preferable to the imposition of transferee liability for it at least distributes the burden of the lessor's taxes equitably among its stockholders.

It is submitted, therefore, that the transferee provisions of the Revenue Acts of 1928 and 1932 should not be construed to impose transferee liability upon the lessor's stockholders.

4. A review of the Lower Court's decision by this Court will prevent litigation on the same question in other Circuits and a probable conflict in the decisions of the various Circuit Courts of Appeals.

Unless this Court reviews the decision of the Lower Court in the instant case, it is certain that the questions presented will be litigated in other Circuits because of their importance to all holders of guaranteed stocks and the large number of these stocks outstanding.

Moreover, it is almost inevitable that one or more of the Circuit Courts for the other Circuits will refuse to follow the decision of the Court Below in the instant case.

It is submitted, therefore, that this Court should review the decision of the Lower Court in the instant case to prevent litigation on the same question in other Circuits and a resulting conflict in the decisions of the various Circuit Courts of Appeals.

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group of persons that the rentals payable to the stockholders could be treated as payable to the lessor. In the instant case it rejected both of these premises and relied upon the premise of constructive receipt and distribution of the rentals by the lessor. Whatever reasoning be adopted to support these decisions it would seem to be clear that they disregard the New York law that the rentals belong to the lessor's stockholders.

CONCLUSION

The petition for writ of certiorari should be granted.

Respectfully submitted,

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MAY, 1944

BRIEF FOR THE RESPONDENTS IN OPPOSITION

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FILED
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CLERK

No. 975

In the Supreme Court of the United States

OCTOBER TERM, 1943

HARTFORD FIRE INSURANCE COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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589265—44

In the Supreme Court of the United States

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HARTFORD FIRE INSURANCE COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 17–21) is not officially reported. The opinion of the Circuit Court of Appeals (R. 49–57) is not yet reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on April 10, 1944 (R. 58). The petition for a writ of certiorari was filed May 9, 1944. The jurisdiction of this Court is invoked

under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

A corporation leased all of its properties to another in consideration of a stipulated rental to be paid quarterly by the lessee directly to the stockholders of record of the lessor as dividends upon their shares of stock. As a stockholder of the lessor, petitioner has received its proportionate share of the rental dividends since 1931. The lessor has not paid the income taxes due in respect of its rental income and has no property in its possession which may be levied upon to satisfy them. The question is whether under Section 311 (a) (1) of the Revenue Acts of 1928 and 1932 petitioner is liable as transferee for the unpaid taxes by reason of the rental dividends received by it as a stockholder of the lessor.

STATUTES INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791:

> SEC. 311. TRANSFERRED ASSETS.
>
> (a) *Method of collection.*—The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, collected, and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in a tax imposed by this title (including the provisions in case of delinquency in pay-

ment after notice and demand, the provisions authorizing distraint and proceedings in court for collection, and the provisions prohibiting claims and suits for refunds):

(1) *Transferees.*—The liability, at law or in equity, of a transferee of property of a taxpayer, in respect of the tax (including interest, additional amounts, and additions to the tax provided by law) imposed upon the taxpayer by this title.

* * * * *

Any such liability may be either as to the amount of tax shown on the return or as to any deficiency in tax.

* * * * *

(f) *Definition of "transferee."*—As used in this section, the term "transferee" includes heir, legatee, devisee, and distributee.

Section 311 of the Revenue Act of 1932, c. 209, 47 Stat. 169, is identical.

STATEMENT

The Commissioner of Internal Revenue determined that petitioner was liable as transferee under Section 311 of the Revenue Acts of 1928 and 1932 for $3,590 of unpaid income taxes due from the Brooklyn Telegraph & Messenger Company for the years 1931, 1932, and 1933 (R. 7–10). The taxes were assessed against the taxpayer and a warrant of distraint issued, but no part thereof was paid (R. 30). Thereupon the tax deficiencies

were asserted against petitioner as transferee (R. 31). The Commissioner's determination that petitioner was liable as transferee was based upon its receipt of dividends upon the stock which it owned in the taxpayer corporation (R. 9). The taxpayer primarily liable for the taxes has no property in its possession from which to pay its obligations (R. 29). Since 1931 petitioner has owned 350 shares out of a total of 2,000 shares of stock of the taxpayer corporation and it received $1,750 of dividends thereon annually (R. 28, 29, 30). The annual dividends exceeded the income taxes asserted against petitioner as transferee for each of the years in controversy (R. 30).

The dispute grows out of a lease executed in 1907 between the Brooklyn Telegraph & Messenger Company and the National District Telegraph Company (R. 28). The former leased all of its properties to the latter for a period of 99 years, in return for which the lessee agreed to pay directly to the lessor's stockholders of record five per centum per annum, payable quarterly upon the 2,000 shares of the lessor's outstanding capital stock (R. 32–34).

The United States Board of Tax Appeals, following certain decisions of the Second Circuit which it cited, held that under those decisions petitioner was not liable as transferee, indicating that its own opinion was otherwise (R. 18–21).

The Circuit Court of Appeals for the Second Circuit overruled the decisions followed by the Board and sustained the Commissioner's determination that petitioner was liable as transferee (R. 49–58).

ARGUMENT

In the companion case, *Western Union Telegraph Co.* v. *Commissioner,* No. 933, the Government has filed a brief on behalf of the Commissioner in opposition to the petition for certiorari filed by the Western Union Telegraph Company involving a question similar to that raised here, the facts in the two cases being comparable, and we refer to our brief in that proceeding for an outline of our views why the petition should not be granted. There are no significant differences in the facts or the principles involved which require extended discussion here. One point should perhaps be mentioned in that the instant petitioner has stated in substance that the question involved is whether it is liable as transferee for the entire income taxes of the taxpayer. The rule is that the Government may follow transferred assets into the hands of any transferee that may have incurred liability under the statute. *Phillips* v. *Commissioner,* 283 U. S. 589. But one of a class may obtain contribution from others similarly situated. *Phillips-Jones Corp.* v. *Parmley,* 302 U. S. 233.

CONCLUSION

There is no conflict. The petition for a writ of certiorari should be denied.

Respectfully submitted.

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MAY 1944.

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